

FINAL TRANSCRIPT

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CMCSA - Q3 2006 Comcast Corporation Earnings Conference Call

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Oct. 26. 2006 / 8:30AM, CMCSA - Q3 2006 Comcast Corporation Earnings Conference Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to Comcast's third-quarter 2006 earnings conference call. At this time all participants are in a listen-only mode. Please note that this call is being recorded. I will now turn the call over to Executive Vice President and Co-CFO, Mr. John Alchin. Please go ahead, sir.

John Alchin - Comcast Corp. - EVP, Co-CFO, Treasurer

Thanks a lot, operator. Welcome, everybody, to our third-quarter call. First of all, I'd like to refer everybody to slide number 2 that contains our Safe Harbor disclaimer and remind you that this conference call may include forward-looking statements subject to certain risks and uncertainties. In addition, in this call we will refer to certain non-GAAP financial measures. Please refer to our press release for the reconciliation of non-GAAP financial measures to GAAP. And now, for opening remarks let me pass to Brian Roberts for his comments.

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Brian Roberts - Comcast Corp. - Chairman, CEO

Thank you, John. We are just excited and thrilled with this quarter. This may well be the inflection point for the cable industry and particularly for Comcast this year. The cable business is really healthier than it's ever been. As you'll see, we reported 12% revenue growth in cable with 15% operating cash flow growth. This is the 25th consecutive quarter of double-digit OCF growth. But what's particularly impressive is how it's accelerating each quarter in revenue growth. In the last four quarters we've basically gone from about 8% to 12% with an increase each quarter.

What's powering this is RGU additions. We had approximately 1.5 million RGUs, John and Steve will take you through the data. That's up 82% and it's the higher level of quarterly additions in company history. And it goes without saying that those RGUs will be there next year producing revenue next year from this year, that's the beauty of a subscription model business. So last year's growth just powers next year's results and I think we're just feeling that building momentum and it's all powered by our triple play bundle.

Phone is now a \$1 billion run rate business as we continue to see rapid growth in subscribers and footprint. We're up to about 30 million homes by year end that will have CDV available. Not all of those are yet doing the full triple play and of course we have the Adelphian markets to look forward to accelerating CDV and triple play in those markets.

Triple play, as we've been saying throughout the year and it's now being confirmed, as it has with other cable companies, stimulates higher growth rates and Steve will take you through some detail on that both for high-speed data, for basic subs for digital. We're positive in basic sub growth this quarter. We'll take you through and it. It's a complicated quarter because of all the swap systems. But the underlying story is the momentum is significant and we believe sustainable.

As I mentioned, we had a very busy quarter in addition to operations. The content business is moving in the right direction, we're very convinced and you'll hear some of that. At the same time we went, as we reported previously, with other cable companies and purchased approximately 20 MHz of wireless spectrum. It gives us great flexibility and optionality on a nationwide basis with other cable partners and in our markets we cover about 99% of our cable territories now where we'll have 20 MHz of wireless spectrum.

And I want to congratulate the bidding team because we managed to do that at prices that are on 20 to 60% or more in some cases below the cost for the identical spectrum in the same auction as other wireless companies paid. We complete successfully the Adelphia and Time Warner swap transactions in the purchase of Adelphia. We agreed to dissolve the Texas and Kansas City partnerships with Time Warner. And over the next year, year and a half or so we intend to integrate these 3.5 million new subscribers.

All of the systems from Adelphia and Time Warner are contiguous to our existing operations and of course we pick up Houston, which is one of the top 10 markets in the country, with terrific growth prospects as a stand-alone new market. All of this allows us to ramp up growth from our video business with video-on-demand, from triple play which bundles our products together, and we believe we are now well positioned, extremely bullish and we think we will have double digit revenue and operating cash flow growth.

We're not changing guidance today because we've said we're not going to do that every 90 days. But rather, we believe that this quarter will be as good or we hope even better in the fourth quarter as we feel the business continues to move forward. With that let me turn it over to John.

John Alchin - Comcast Corp. - EVP, Co-CFO, Treasurer

Thanks a lot, Brian. As Brian just stated, we're very excited about the strength of the results in this quarter and really believe that this momentum is sustainable as well as being significant. Before getting started with the numbers let me describe how we're presenting the results for the third quarter.

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In a nutshell we're presenting cable on a pro forma as adjusted basis throughout the presentation. Pro forma as adjusted cable results include the results of the Adelphia/Time Warner transactions and the Houston system as if they were acquired on January 1, 2005. And don't forget, they exclude the LA systems that we owned, the Dallas system that owned and the Cleveland system that aggregated about 1 million subscribers, and those systems were transferred to Time Warner as of the same date. Please refer to the press release and especially to note number 2 and table 7a and b for the details of this pro forma presentation.

On the other hand, in the consolidated results first of all they include all the acquisitions as of the date of their closing, Adelphia/Time Warner is of July. Secondly, they present Dallas, Los Angeles and Cleveland as transferred to Time Warner as discontinued operations. And thirdly, with respect to the Houston system that is still subject to certain approvals and closing conditions, it's accounted for on the equity method -- equity method investment.

So driven by strong results at Comcast Cable and reflecting the impact of the Adelphia/Time Warner acquisitions, consolidated revenue for the third quarter increased 22% to \$6.4 billion while consolidated operating cash flow grew 25% to \$2.4 billion. Pro forma cable revenue increased 12% and operating cash flow 15%, and we'll review the drivers of those results in the following slides.

Content revenue for the third quarter increased 9% to \$258 million reflecting increases in the network ratings, advertising revenue and distribution revenue. Third-quarter content operating cash flow increased 22% to \$88 million. The current quarter is showing really strong and improving results in this segment. We've unveiled a new name, Versus, for the network formerly known as OLN. Next week on Halloween we'll (indiscernible) the new multiplatform network available on video-on-demand, on line and wireless devices. This is Fearnert and it will be dedicated to the best of horror programming. There are a lot of good things coming out of our content division and we congratulate the group on all the progress they've made.

Consolidated net income increased 1 to \$1.2 billion or to \$0.58 a share in the third quarter compared to net income of \$222 million or \$0.10 a share in the same period last year. The current quarter included one-time gains net of tax of \$435 million and \$234 million related to the Adelphia/Time Warner transactions and discontinued operations respectively. If you were to exclude these gains, adjusted net income for the third quarter would be \$548 million or \$0.26 a share, up from \$0.10 a share a year ago. You'll see the details of those calculations -- of the \$0.26 a share in table 7c at the back of the press release.

Slide number 5 speaks to the record-setting quarter of RGU net additions that were driven primarily by our triple play offering. For the quarter we added 1.5 million RGUs which is fully an 82% increase. 94% of these net adds, or 1.4 out of the 1.5 million, were from our historical Comcast systems. This shows the strong growth and momentum in our core business. RGU growth was driven by strong net adds from all of our products. In fact, each one of products posted better net adds in the third quarter of '06 than they did a year ago.

Steve is going to describe the drivers of our RGU growth, so I'll just highlight a few points. First of all, with respect to basic -- our historical systems added 24,000 subs this year, that's an improvement from a loss of 39,000 subs in 2005. Secondly, we added 558,000 digital subscribers, the largest quarterly increase in our company's history to end the quarter with 12 million -- 12.1 million digital subscribers and a digital penetration rate of 50%.

Included in the digital subscriber additions are 423,000 enhanced cable customers. Growth in the number of enhanced cable customers has increased steadily in 2006 as we incorporate this level of service into our entry-level \$99 triple play offering. At the same time, we added 315,000 digital subscribers with advanced services, that's our high definition and DVR offering. We did that this quarter and so far more than 1.5 million in the past year. Remember, existing customers who upgrade to our high def DDR service are not counted as a new RGU if they already subscribe to the digital service. But at the same time they contribute incremental revenue of 5 to \$10 per month.

In high-speed data and what is seasonally the strongest quarter of the year, we added 536,000 new customers, the most quarterly additions in two years. In fact, this is the second highest level in our company's history. In CDV we added 483,000 new customers building on the momentum from earlier in the year as we added over 200,000 in the first quarter, 300,000 in the second quarter

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and 483 in this quarter. So year-to-date we've added 3.4 million RGUs, that's 66%, above last year's take. And we've added more RGUs this year to date than we did for the entire year last year.

RGU additions, as we show on slide number 6, are driving double digit revenue growth. Total video revenue increased 9% to \$4.2 million and this is the fourth consecutive quarter of accelerating video revenue growth. The year-over-year increase reflects a 16% increase in the number of digital subscribers and increasing consumer demand for the digital features that we're offering. Digital average revenue per unit, which captures the incremental revenue from all our various levels of digital service increased 9% from the prior year.

So if you look at the mix of digital customers that we now have, they essentially fall into three categories. First of all, about 14%, as we show in the press release, of our digital customers are in the enhanced cable category and on average those customers pay us about \$50 a month. 52%, or the majority of the digital customers, the 12 million that we have in total, have subscribed to what we call Digital Cable which is the full digital offering and they pay us on average about \$65 a month. And then finally, we have the category that I just referred to that takes the HD DVR, or what we call Digital Cable with advanced services, and on average they pay us in excess of \$70 a month.

All of our digital customers have access to ON DEMAND and we continue to see strong increases in movie and event purchases from those customers who have ON DEMAND. Pay-per-view revenues increased 31% in the third quarter and pay-per-view revenue has shown strong growth with the rollout of ON DEMAND increasing more than 25% on average for each of the past three years.

Our high-speed data consistently has posted terrific results. High-speed data revenue increased 22% to \$1.4 billion in the quarter reflecting record setting subscriber additions and stable average revenue per unit of \$43.14. We ended the third quarter with a penetration rate of 24%, up from 20% a year ago. The Comcast Digital Voice product that we're offering continues to ramp up, and as a result cable phone revenue increased to \$252 million in the quarter and, as Brian noted, this represents a \$1 billion a year rate business with lots of growth ahead of us. This is driven by strong additions to the CDV service as discussed earlier, and our phone business has grown 50% from the third quarter of last year. Steve is going to cover more of this business as he goes through his slides.

Finally, in the advertising category, we increased revenue 10% to almost \$400 million reflecting the growth in the core business as well as political advertising in this quarter. On slide number 7 we illustrate the accelerating cable revenue and operating cash flow growth that's driven primarily by our triple play offer. Growth has expanded our margins to 39.6% in this quarter, fully 110 basis points above the level of a year ago.

The margin improvement reflects strong revenue growth and our continuing success in controlling the growth of operating costs even as we experience higher service and installation activity from the record RGU additions and as we incorporate lower margin operations from the systems acquired from Adelphia/Time Warner and the Houston system. The impact of these acquired systems on overall cash flow growth is flat to slightly accretive to the overall revenue of the end cash flow of the business.

On slide number 8 we've shown you the breakdown of the 3.5 million subscribers that we've acquired. We completed the Adelphia/Time Warner transaction in July and expect to complete the dissolution of the Texas/Kansas City joint venture in the first quarter of next year. And what we're able to do with this transaction is to convert passive investments to cash flow producing assets with considerable revenue and operating cash flow opportunity. Together both transactions will add 3.5 million new customers to Comcast, an increase of about 15% to the total previous subscriber base.

We're really excited about the systems that we're receiving because all of the Adelphia/Time Warner systems fill in existing or extend existing markets -- so they fit us like a glove. There is considerable upside in the systems for new product penetration. The systems acquired from Adelphia have lower product penetration than the historical Comcast systems. For example, the Adelphia systems have digital penetration of 41% versus 50% for our historic system. And the acquired Adelphia systems currently do not have any phone service, any VOD or, by virtue of that, the triple play offering.

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The acquired systems on average have cash flow margins in the mid 30% range. Just like the integration of AT&T Broadband, we'll bring these margins to Comcast levels over the next 18 months or so. The acquired systems will require more capital over the next 12 to 18 months than the average Comcast systems do for a couple of reasons. First, we need to complete the upgrade of the Adelphia systems, they're currently at about 85% rebuilt. And secondly, we need to make all the systems Comcast like, meaning to give them provisioning that's similar to what we have -- adding CRANs, digital simulcast and giving from a products standpoint services like phone, VOD and higher high-speed data speed levels.

In relation to slide number 9 we should point out that we've updated and reaffirmed our cable guidance to include the Adelphia and Time Warner transactions and the Houston system to be received with the expected dissolution of the Texas/Kansas City cable partnership. The details of the guidance update are included in today's earnings release. To assist investors with their financial model we have set the 2005 base by disclosing pro forma revenue, cash flow and RGU additions for the cable business in 2005 including Adelphia/Time Warner and the Houston systems. Investors will now be able to forecast expected 2006 levels from this new base.

Supporting the record RGU growth we're reporting this year and including in acquired systems, CapEx is expected to be approximately \$4.5 billion. This pro forma full-year CapEx number is consistent with the data we presented at a recent investor conference where we highlighted the range of approximately \$500 million of annualized capital investment required for these acquired cable systems. Capable capital expenditures for the quarter were \$1.2 billion compared to \$1 billion a year ago. The increase in CapEx is directly associated with the increase in RGUs. CapEx increased 25% to support an 82% increase in RGU net adds. CapEx continues to be predominantly variable and revenue driven.

For the third quarter more than 75% of cable capital expenditures were variable and directly associated with new product deployment and consumer demand for our advanced services. When we look at the returns on variable capital associated with RGUs the result is incremental returns of more than 30% on a leveraged after-tax basis as we generate on average about \$200 of EBITDA per RGU.

On slide number 10 we show that we've generated \$870 million of consolidated free cash flow in the third quarter. This is 38% or a \$240 million increase when compared to last year's levels. On a year-to-date basis free cash flow increased over \$800 million to \$2.2 billion due primarily to the 30% increase in cash from operations driven by strong cash flow growth at Comcast Cable as well as an improvement in working capital.

The balance sheet update is shown on slide number 11 and I just want to clarify a few details here. Cash increased almost \$2 billion in the quarter to \$2.8 billion. Our public debt issuance in the third quarter totaled fully \$3.4 billion in anticipation of funding needs for Houston and the wireless spectrum. We accessed two new debt markets for our company in the quarter -- the floating-rate market for \$1.25 billion and the retail market with a 49 year issue for an additional \$1.1 billion.

Since the beginning of 2005 we've refinanced almost \$4 billion of debt at rates that are 200 basis points below previous coupons. This results in annual interest savings of \$80 million. The average cost to debt being issued during this period is about 6.1% and the average life exceeds 21 years.

During the third quarter our investment balance declined to \$7.2 billion from \$11.8 reflecting the Adelphia/Time Warner transaction. Our investment balance of \$7.2 billion will decline further as the Texas/Kansas City partnership closes at the beginning of next year. Also included at this amount is our partnership interest with Insight, our Time Warner stock and our investment in the wireless spectrum. The remaining balance reflects investments that have been monetized. The third-quarter debt level of \$27 billion is unlikely to decline through year-end as we continue to invest in our business and return capital to shareholders.

On slide number 12 we show that we've invested billions of dollars this year to grow our business while continuing to invest in our own staff. This investment activity will likely exceed \$5 billion as we show on slide number 12. We bought back 14.6 million shares in the quarter for a total investment of \$493 million. Year-to-date we've bought back over 64 million shares for an investment of \$1.9 billion, that represents a 3% reduction for this year alone.

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So not only are we able to report a fantastic quarter from an operational standpoint, but we're continuing to use our financial strength of our business to invest in future growth and competitive advantage and at the same time to return capital to shareholders. With that let me pass to Steve.

Steve Burke - Comcast Corp. - EVP, COO

Thanks, John. I've been with Comcast now for more than eight years, and during that time we've had 32 earnings calls and some of them have been pretty good. However, out of 32 quarters I would have to say this one is the best. John has hit the financial and RGU highlights which speak for themselves; so this morning what I'd like to do is zero in on our real engine, the thing that's really driving our results, the triple play.

There are five key components to our triple play strategy. First, phone represents an attractive new line of business in its own right. The majority of the 46 million homes we pass have Wireline phones. We are often the only viable alternative to the Bell's and we can deliver phone in a cost-effective manner with our existing platform and people. So it's a good business for us.

The second component of our strategy is that we use phone to deliver a very attractive price/value relationship for all three of our key products -- video, data and voice. This may seem obvious, but it's a really critical point for understanding the impact of the triple play on all of our business. It's about much more than just selling phone.

\$99 for all three products is a great price value. Before the triple play you could if you wanted to find video at a cheaper price and DSL for less than cable broadband, but at \$99 we're competitive even if someone takes the time to buy ala carte from three different providers. With this price/value relationship we attract price conscious customers who otherwise would not subscribe. We can also win back video and data customers who otherwise would see no reason to switch.

The third component of our triple play strategy is that it's a very efficient business proposition for us. Instead of multiple monthly promotions we now have a simple consistent message; this is easier for consumers to understand and our employees to explain. When we get a triple play subscriber we use one platform and one installation so it's operationally efficient as well.

The fourth component of our triple play strategy is up selling. Once someone calls we offer services such as digital, high-definition or HBO and, as a result, our average triple play subscriber spends over \$120 a month with us.

The final component in our strategy is churn reduction. When someone has their Internet address and telephone number with us they're less likely to leave. The effect of this churn reduction on our basic subscriber count should grow over time. These five areas are pieces of our triple play strategy and so far each of them is working better than we planned at the beginning of the year. We see that in the number of subscribers we're adding -- total phone subscribers; we also figured CDV would be a drag on our 2006 financials and the opposite has been the case.

Now what I'd like to do is go to some slides which show you how our triple play rollout is progressing. The first slide is slide 13. This slide shows CDV marketable homes. At the end of the quarter we're up to over 30 million homes out of the 46 million home total, or about 66% of our footprint. We should be at over 80% of homes marketable by the end of this year and 90 plus percent by the end of next year. About half of these CDV-ready markets are mature in the sense that they are aggressively selling the triple play. Normally a market starts the triple play three to six months after launching phone, so this number should grow rapidly in the future.

The second slide shows quarterly net adds per CDV. These numbers are for the entire company including newly acquired systems, but since Adelphia hadn't launched phone, this growth came primarily from heritage Comcast markets. The 483,000 net adds for the quarter was about 60% over our internal budget. In our historical Comcast systems we actually added more phone during the quarter than data customers, despite the fact that phone its second year of existence and data is about eight

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years old. In fact it took high-speed data five years to add over 400,000 subs in a given quarter and with phone we did it in less than two.

This next slide shows some of the key metrics we use to monitor this business. The first metric is sell-in rate or the percent of new customers who take the triple play. In the second quarter we averaged a 25% sell-in rate across the country and only Boston was over 35%, so this is good progress. The second metric is the percent of triple play customers who are new to Comcast. This is a very important statistic because new customers bring more basic and high-speed data business when they join our subscriber ranks. Finally, we're doing a good job selling triple play customers additional products such as high-def, digital packages and HBO, and the average triple play customer generates over \$120 per month in revenue.

The next slide shows the effect of the triple play on basic customers. For the first time this quarter we think we have conclusive evidence that the triple play is lifting basic subscriber counts. For some time in our business as a whole our basic sub adds have been declining. For each of the last three quarters this trends has been reversed and we've done better than the last year regarding basic subs. Triple play is clearly part of the reason why. In markets with the triple play we gain more subscribers for the Company as a whole. In heritage Comcast markets the effects are even more noticeable where we've improved by 63,000 subscribers, our basic sub situation in the third quarter of 2005 versus a year previously.

The next slide shows the effect of the triple play on high-speed data. This chart suggests we might have gained fewer data subscribers than last year without launching phone, but in fact the triple play seems to be changing the fundamental growth curve of this business. The good news about these slides is that these trends should continue and in some cases accelerate in the future. Some acceleration will come from expanding our marketable home base from 66% to over 90% in the next year or so. Some will also result from the maturation of triple play markets as we get better at operations and marketing with more time. Finally, as our base of triple play customers grows we will have more loyal three product customers and churn should continue to decline across all of our business lines.

So in conclusion, the triple play is really starting to kick in. We're very excited about it. You can clearly see it in our financial results and our RGU metrics. It's having a very profound effect on many aspects of our business and we look forward to continuing to roll out this strategy in the years to come.

John Alchin - Comcast Corp. - EVP, Co-CFO, Treasurer

Okay, operator, let's open up for Q&A.

QUESTIONS AND ANSWERS

Operator

(OPERATOR INSTRUCTIONS). Craig Moffett, Sanford Bernstein.

Craig Moffett - Sanford Bernstein - Analyst

Good morning, everyone. A question on your margins, if I could. You've had a lot of inflation inactivity, if you will, with new installations. Some of that's being capitalized, but there has to be a significant amount of that that's being expensed as well. And yet, you've had no margin reduction. Is that an indication that the underlying margins of the business are expanding faster than it appears in the numbers?

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Brian Roberts - Comcast Corp. - Chairman, CEO

What's interesting, and this is something that was a pleasant surprise as we worked our way through the year -- we've added something like 45,000 new employees. And when we add a new employee typically the training session makes that employee less than productive for the first 60 or 90 days. So we had assumed as we launched phone that it would actually depress our margins.

What has in fact turned out to be the case is that when you show triple play customers at an average ARPU of \$120 it is modestly accretive to our overall margin. And so we've been able to absorb all of these employees and all of the attendant training and other costs and our margin has been expanding which is a pleasant surprise.

Craig Moffett - Sanford Bernstein - Analyst

And one more question if I could. Could you update us on your thinking account Insight and what you might do with that option?

Brian Roberts - Comcast Corp. - Chairman, CEO

We don't have any new news to report and when we do we'll tell you.

Craig Moffett - Sanford Bernstein - Analyst

Okay. Thanks, Brian.

John Alchin - Comcast Corp. - EVP, Co-CFO, Treasurer

Thanks, Craig. Next question, please, operator.

Operator

Jessica Reif Cohen, Merrill Lynch.

Jessica Reif Cohen - Merrill Lynch - Analyst

Thanks. Maybe a follow-up to that question, just a more general question is could you discuss your appetite overall for more cable? The second question is what is the ARPU on triple play subs in their second year? And then finally, could you discuss how much you might spend on the wireless spectrum and when do you think you might do that?

Brian Roberts - Comcast Corp. - Chairman, CEO

Our appetite for cable continues to be we're very bullish about the cable business -- I don't know how you could not be given these results, given what's been happening and what appears to look like it wants to continue happening. There is not a strategic need to change what we've really been focused on, Jessica. As John described, a lot took place in this quarter because of Adelphia and Time Warner, but to convert a lot of the nonoperating assets into operating systems and if we think we can get superior returns given our scale I think implicit in the first question about margin is we are getting better as a company. Our scale, our programming discounts -- you add it all together, a little bit here, a little bit there, it makes a big difference and the business is moving in a good direction.

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On the wireless question, again I think when we're ready and have something meaningful to say there we will. At this point we really viewed it as a strategic opportunity to put some capital into the spectrum. We think we did so opportunistically in an auction where there was a lot of supply of frequency being sold and perhaps not the same match in demand. So we were able to buy it at sort of 45% of the prior auction cost per MHz top and get all of our markets. That allows us to now engage in a variety of conversations to see what are the best technologies, when is the best timetable? As we've said, we really want to see what consumers want and we're going to explore that.

And we also have a good relationship with Sprint that we would like to bring some products to market as we previously reported. So we'll have more to talk about that, but I look at Comcast strategically, big picture, company this size and say -- okay, if you want and need to and when the timing is right to be able to have your own frequencies and your own network integrated perhaps with others or with your own cable engineering, we're in a position to do that and we're in control of our own destiny and we did so at an opportunistic price. And your third question and I'll turn over to Steve on the second year of triple play.

Steve Burke - Comcast Corp. - EVP, COO

Well, we don't have a lot of places where we've entered the second year, so it's a little early to tell. But the expectation is that when someone goes off the original first-year promotion the average ARPU for that customer would increase in range of 20 to \$30.

Operator

Aryeh Bourkoff, UBS.

Aryeh Bourkoff - UBS - Analyst

Good morning. Just a few things. First of all, you have 11 million high-speed Internet subscribers now given your growth, what are your plans for developing the online platform for video? I know you launched JumpTV recently, but could you do a YouTube like product? Are people coming to you given that scale and looking for things that are more innovative online?

Secondly, obviously you mentioned wireless, but there's been a lot of talk about the Sprint partnership. Are you happy with the Sprint partnership the way it is or is this potentially going to be something that you're interested in rolling up at some point? And then related to that, is this going to be an organic growth story for a while, Brian? Obviously momentum is in your favor, accelerating as you said. You've brought in some properties in the quarter. Is this going to be the system, the home footprint for a while and we're going to see it grow -- or are you looking for acquisitions? Thank you.

Brian Roberts - Comcast Corp. - Chairman, CEO

You know, we said at the beginning of the year we were going to focus on execution. I think Steve and his team, I'd like to say the three Daves, Dave Watson, Dave Scott, David Juliano. They're focused on triple play, taking a company of this time -- I don't think folks quite appreciate how many markets and how broadly diverse in 30 states and to have this kind of ramp up this quickly and appear to just be getting going and now have Adelphia to integrate. It's just a marvelous execution. And so the broader answer to the question is that's where our focus is.

There is no cable really for sale on a large basis, so I think, yes, we are focused on this footprint and executing Larry and John and Bob Pick and the team that has been doing the rollup and the conversion of the nonoperating assets into operating assets. So as to your Internet question and video, we have been saying for some time that the Internet is friend to video, Internet 2.0 is all about video. Video works better on Comcast than it does on our competitors and in most homes and you don't know which one of those homes you are if you're too far from a central office.

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So if you can get the best a lot of customers want it and Steve described now being able to package that for better value. We're getting back customers that perhaps initially went for price but now want the speed. Somebody told me a statistic -- I'm not perfectly sure this is right -- it's something like 4% of the bits last month that go over broadband were YouTube. All that video is not traditional television video and it's a different kind of experience for the consumer.

And so, if you can get that experience, it used to be music was the driver; I think video is going to be the driver but I think it's a different type of video experience. It's not really cable channels in their entirety at all. And it's a different revenue model, most of this video is free.

So we're pretty excited with the position of where the consumer wants to go, personalization, and where our networks want to go. And we are going to continue to invest and to market and I think you're going to continue to see a great business.

John Alchin - Comcast Corp. - EVP, Co-CFO, Treasurer

Operator, can take the next question? We still have a number of people in the line here. So if you can restrict your question to one question rather than three that would give others a chance to ask a question. So let's go to the next one.

Operator

Doug Shapiro, Banc of America.

Doug Shapiro - Banc of America - Analyst

Maybe I'll make it one and a half questions. For Steve, on CDV it looks like the net adds per homes marketed is up like mid-30s sequentially. Just kind of curious, when do you think those kinds of efficiency gains hit the wall? And maybe put a different way, at what point do you think you're actually getting supply constrained? And the half question is, I just was wondering if you had on triple play sell-in, any sense of what that looks like in your most successful or most mature markets?

Steve Burke - Comcast Corp. - EVP, COO

You're absolutely right, what I call the maturation of a market. Typically we launch CDV and wait three to six months before we even start the triple play. I would say the majority of our markets to this point are still what I would call supply constrained; in other words we don't have enough people to handle all of the demand. We might have a few markets such as Boston where we're staffed appropriately to really be going 60 miles an hour in terms of marketing and everything else. But I think well into next year we're going to have this affect of markets maturing and we're going to have this effect of growing our units faster than we're growing our footprint. I think that's just a fact that it's here to stay.

We have some markets that are over 35% in terms of sell-in, but you know, trees don't grow to the sky and I would not see that sell-in number getting too much higher than 35%. I think 35% is very healthy. To be taking 35% of your customers that call in for cable service and selling all three products and getting on average over \$120 a month I think is a pretty good number.

Operator

Spencer Wang, Bear Stearns.

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Spencer Wang - *Bear Stearns - Analyst*

Thanks and good morning. John, you said 94% of your RGUs came from historical Comcast. Is that true across -- broadly true across all the various products -- digital voice, digital and broadband? And then secondly, your free cash flow guidance, are you guys still expecting 25 to 30% conversion? Thank you.

John Alchin - *Comcast Corp. - EVP, Co-CFO, Treasurer*

Thanks, Spencer. If you go to slide number 5 you'll see the breakdown by column of historical and acquired systems. And as I mentioned in my comments, we actually on our own would have done better had we not had the drag of losing 14,000 basic subscribers from the acquired systems. Digital -- all but 7,000 of the 551,000 digital customers were ours. High-speed data, slightly higher proportion of those customers came from the acquired systems, 76,000 out of 536,000.

So you'll see all of the detail there on that slide. And secondly, with respect to the guidance on free cash flow conversion, leaving that exactly at the 25 to 30% rate that we had given as guidance at the beginning of the year. And you'll see that as the third quarter we actually delivered 36% in the third quarter of this year as a conversion rate. That's on slide number 10.

Operator

Bryan Kraft, Credit Suisse.

Bryan Kraft - *Credit Suisse - Analyst*

One question. How sustainable do you think the roughly 8% video ARPU growth rates that we've been seeing for the past three quarters are? Do you think you can sustain them through next year or do you think it moderates a little bit back towards some of the historical ranges of 5 to 6%? Thank you.

Brian Roberts - *Comcast Corp. - Chairman, CEO*

Well, this is sort of a flip answer, but I think in some ways it doesn't matter. And I think what we're focused on is increasingly selling all three products in a bundle and trying to get as many people to take all three as possible. And I think you can see -- and my prediction would be other cable companies would do this as well -- I think that there may be a moderation of price increases, basic cable price increases as the overall business morphs and changes.

So even if the basic -- even if the video revenue line grew more slowly as long as phone and high-speed data grew quickly I don't think that's necessarily cause for concern. That having been said, I think you're going to see us do better in terms of basic subscribers which will contribute to the video growth line. I think you'll see us continue to roll out a lot of digital products in advanced services like high-def, etc. So we don't see that number falling off a cliff, but if it declined and the other numbers picked up we don't necessarily think that's a bad thing.

Steve Burke - *Comcast Corp. - EVP, COO*

Let me if I might use this as an opportunity to broaden that question and make another point. I've been visiting with investors from time to time; people last where is your priority? Is it (indiscernible), is it basic ARPU growth, is it EBITDA growth, is it free cash flow growth, is it RGU growth, is it basic sub growth? And this company on the margin, our priority, we are totally unified, is RGU growth. We believe we have a moment in time, this is a unique opportunity to -- it's exceeded our expectations how much consumers value this bundle. And we are going to continue to push that as aggressively as we can.

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And the great news is having all these other good effects as we've been talking about, whether it's basic sub growth or EBITDA growth. But in terms of our management focus, it's really to just see within the limited -- supply constrained limit of how much we can physically hire and do the work, which is a stress, but the highest class problem but one that we take seriously, we are going to try and sell as many RGUs as we can this year and next year. Thank you.

Operator

Jeff Wlodarczak, Wachovia Securities.

Jeffrey Wlodarczak - Wachovia Securities - Analyst

Steve, video penetration is about 51% at quarter end. You clearly have the most compelling product on the market for the foreseeable future. So why is that penetration rate not going to move significantly higher? And then I a half question for Brian. There's a lot of noise around you guys potentially buying Yahoo! and Sprint. Obviously you can't get into specifics, but are you still comfortable with your sort of build partner strategy and content and the Internet? Thanks.

Brian Roberts - Comcast Corp. - Chairman, CEO

Traditionally one of the hardest metrics in a cable company to move is basic sub penetration. And a lot of the markets that we inherited when we bought AT&T Broadband had lower penetration than historical Comcast and it's historically been very, very difficult just because people, once they make a decision on their supplier, tend to be lowest to change. That having been said, I think for the first time with the triple play we have a real opportunity to talk to the other 50% of those 46 million homes. In other words, we have 23 million homes that we're not in now or some number like that that we could be in and now have a reason to speak to those customers.

There has also been recent evidence, and I'm thinking of Cablevision in particular, where their basic sub growth has accelerated to a point where their penetration has started to move and we may be a year or two behind them. That would be a wonderful thing if it happened. Traditionally that's been a very tough thing to accomplish but we'll see.

Steve Burke - Comcast Corp. - EVP, COO

So let me first comment that -- just very directly -- three product customers churn less than one or two product customers churn. And the strategy of focusing on getting as many, whatever the rate you charge for that three product bundle turns out to be, I think we are putting the Company in a better position.

And other companies that have been at this longer are seeing basic subs even grow faster. And so as we've seen, this is an improvement in the third quarter, we'll see what happens in the future but our focus again is on the overall RGUs. It is tough to get people to change their incumbent provider even on one service and if they've already bought that competitor we're getting some progress there. Hopefully it will accelerate.

We don't comment on any potential specific situations. Let me just say that strategically I think this company is in a very enviable position right now. We're able to build new products. We don't feel we have to buy in all cases or in many cases. A lot has changed in the last couple years.

We really wanted to get the content moving in a direction that would allow the personalization of television and I think you're seeing that with 1.5 billion VOD sessions, ON DEMAND sessions in the last 12 months and growing and the kinds of content we announced today, a new network, Fearnetwork, which is an innovative attempt to have a broadband and a VOD network that may not have an actual channel but rather a virtual channel but give consumers exactly what they want who love the fear category.

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So we are continuing to try to innovate. I think the content division is doing that for us quite well. And our Internet division will be coming out with new products in the next 12 months that go at some of the trends -- whether it's community or video and cross platform services. So I like where we're at. I like the development team we have and beyond that I just can't comment.

John Alchin - Comcast Corp. - EVP, Co-CFO, Treasurer

Okay, operator, we're coming up on an hour so maybe we'll take a couple more questions and then call it quits.

Operator

Kathy Styponias, Prudential.

Kathy Styponias - Prudential - Analyst

I know that one of the things that makes it exhaustive for management teams to deal with Wall Street is despite what are phenomenal numbers is the question of what's coming next. And in that regard my question is regarding phone opportunities in the small and midsize businesses. I was wondering if you can talk qualitatively about what needs to get done in order for you to pursue that opportunity and in what time frame. And of the 4,500 employees that you added this year, how many of those or roughly estimate how much of that has been spent already to go after that opportunity? Thanks.

Brian Roberts - Comcast Corp. - Chairman, CEO

Let me start by saying that that's not a Wall Street question that I have any question with in terms of what's next. Because what has changed -- because again in the last couple years people have said, okay, after phone -- residential phone, what's next which since we hadn't really got to this kind of great success it was hard to really be wanting to talk about. I think we are very settled as to what's so exciting is there is another act coming and you put your finger right on it.

Let me turn it over to Steve to shed some light. I think you'll have a lot more discussion of this next year and the year ahead. I think we'll come with more detailed plans at our analyst get together next year. But I think there is a growing consensus in the industry that you take this infrastructure and you roll it into an even bigger marketplace in small and medium sized businesses.

Steve Burke - Comcast Corp. - EVP, COO

We are coming up on the end of our budget cycle for next year and every single system in the Company now has a very concrete plan -- capital OCF, hiring, etc., for commercial. We announced several weeks ago that we've hired a gentleman by the name of Bill Stemper as the President of our commercial business. Bill was at Cox and was responsible for the Cox commercial business which has been very successful. So you're going to start to see it in our numbers and we're very, very serious about it.

And the idea really is you launch phone, then at some point phone matures to triple play, then you really do need to make sure that you harden your network even more than it's been hardened for phone. There is a certain amount of investment that needs to take place; you want to make sure that when you come in -- we think the small and medium-size business is literally starved for another alternative. But when you come in you want to make sure that you do an excellent job and Bill and his team are making sure that we approach the market aggressively but also carefully at the same time.

So you'll start to see a lot more action in hiring, etc. Of the 4,500 people that we hired, the majority of those people are technicians and call center people who are dealing with the residential CDV and triple play rollout. They are not commercial. You'll start to see some commercial heads -- we've hired commercial people, but it's not a material amount of the 4,500. That hiring is going to accelerate -- is accelerating now and it's going to accelerate in 2007.

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I try to view that as a whole new business opportunity and we'll talk more detailed about that base case, what the return on investment is, the likelihood of success and we'll have more of those metrics as we put it together. But our instincts, wouldn't you say, are this looks like perhaps an even higher margin opportunity because you charge more and you have less sites that you do it to and it's a better value in some ways because right now there is no competition for small and medium-size businesses and we have an ability to come in and be the first real competitor in that market for people who want competition in high-speed Internet and voice.

Operator

Vijay Jayant, Lehman Brothers.

Vijay Jayant - Lehman Brothers - Analyst

Just a quick one. Some of your colleagues in the business have started deploying switch digital video. Do you think that's a technology you will want to adopt for improving efficiency for potentially high-definition and the timing if that is the case?

Brian Roberts - Comcast Corp. - Chairman, CEO

We think there's a variety of ways to clear more bandwidth and we've been doing something called simulcast which has been rolled out through the majority of the Company. We're doing a switch digital video trial in Denver. We like the technology and I think what you'll see is an adoption of a variety of approaches depending on the system and the timing and how the technology develops.

John Alchin - Comcast Corp. - EVP, Co-CFO, Treasurer

Thank you all. We'll talk to you next quarter.

Operator

There will be a replay available of today's call starting at 11:30 AM Eastern Standard Time. It will run through Saturday, October 28th at midnight Eastern Time. The dial-in number is 800-642-1687 and the conference ID number is 735-9179. A recording of the conference call will also be available on the Company's website beginning at 12:30 PM today. This concludes today's teleconference. Thank you for participating. You may now disconnect.

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